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AT LAST THE INTERNATIONALIZATION OF RETAIL BANKING?
THE CASE OF THE SPANISH BANKS IN LATIN AMERICA

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AT LAST THE INTERNATIONALIZATION OF RETAIL BANKING? THE CASE OF THE SPANISH BANKS IN LATIN AMERICA

Abstract

Since 1995 two Spanish banks—Banco Santander Central Hispano and Banco Bilbao Vizcaya—have become the largest foreign banks in retail banking in Latin America. This recent development merits careful analysis because foreign direct investment is rare in retail banking. We find that the Spanish banks are exhibiting asset-seeking, asset-exploiting, and oligopolistic behaviors, thus posing no serious challenge to established theories of foreign investment. We discuss the implications for research on cross-border banking.

Introduction

In a review of the literature on cross-border banking, Tschoegl (1987) concluded that retail banking does not generally lend itself to foreign direct investment (FDI). Retail banking is a mature industry and there is no reason to expect foreign banks to have any particular advantage over domestic banks familiar with their local environment. Historically, only Citibank (now Citigroup) has pursued a global retail strategy, though it has focused on credit card and banking services for an urban professional class without attempting to enter the mass retail market as the Spanish banks are doing.

Since 1995 three Spanish banks—Banco Santander (Santander), Banco Bilbao Vizcaya (BBV), and Banco Central Hispano (BCH)—have become the largest foreign banks in Latin America. (In 1999 Santander and BCH merged to form Banco Santander

Central Hispano - BSCH). These banks have spent over US$4 billion to acquire large stakes in almost 30 major banks in more than ten different countries (Table 1) accounting for some US$40 billion in assets. Moreover, Table 1 does not include the numerous acquisitions of credit card, consumer and commercial loan, insurance, stock brokerage and pension fund management companies, or earlier acquisitions and pre-existing operations. What is novel about this expansion is that the Spanish banks are acquiring some of the largest domestic banks in their target countries and entering the general commercial and mass retail market. Furthermore, the stock market seems to have endorsed this strategy. Of the world's 50 largest banks (in terms of market capitalization), BBV (at 56%) and Santander (47%) ranked 1st and 3rd in terms of total stockholder returns between 1993 and 1998 (The Banker, July 1998, p. 20). The recent turmoil in emerging markets reduced the banks' valuations but this reflects judgments about the markets and not necessarily about the banks' activities.

Our purpose in this paper is to analyze this unprecedented phenomenon in the light of existing FDI theory. The focus is on the phenomenon, not the theory, and our research approach is idiographic (i.e., a case study). As Bengtsson et al. (1997) point out, idiographic research seeks to create rich description that emphasizes qualitative and multi-aspect concerns, in contrast to the nomothetic approach, which seeks statistical generalizations based on analysis of a few aspects across large samples. Our aim is not to prove, i.e. test, a particular explanation; rather, we intend to describe a unique phenomenon and see the extent to which existing theories help us understand it or require modification (Eisenhardt 1989). Our research included semi-structured interviews with 33 bankers and bank regulators in Latin America and Spain (see Appendix A), and

examination of bank documents, industry reports and banking system statistics.

The sudden foray by the hitherto unknown Spanish banks brings up the standard six questions in any study of foreign direct investment (Caves 1996)—who, where, what, when, how and why? **Who** is the issue of exactly which banks are responsible for the phenomenon. **Where** raises the issue of the choice of Latin America as the target region. **What** is the question of retail banking—the banks' apparently anomalous choice of the product market to enter. **When** involves the timing of the banks' expansion. **How** is the question of the different market entry strategies. Lastly, **Why** is the issue of the reasons behind the banks' strategies. We deal with each of these six questions in turn.

Who: Santander, BBV and BCH

BSCH and BBV are the survivors in an ongoing process of consolidation in Spain's banking sector. For decades seven big institutions dominated Spanish banking. Given their extensive branch networks and the tight regulatory framework, they grew primarily by acquiring smaller institutions. For much of the postwar period these banks operated as a de facto cartel; the banks met regularly to fix interest rates and lobby the government (Pérez 1997). By the late 1980s, however, the situation started to change. Competition for market share intensified and the government encouraged mergers as a way to break the cartel and to prepare for European integration. Intermediation margins fell, and, though still solid, the banks worried about their long-term profitability. Besides entering new product markets—stock brokerage, pension funds, and value-added services—several of the big banks began to view international expansion as a way to enhance profitability by exploiting their skills more fully.

In 1995 Santander, BBV and BCH were fairly similar in terms of age, size and focus on retail banking. Yet, they differed in terms of control, managerial style, and strategic posture (Interviews #7, 9, 14, 16 and 17 in Appendix A). A brief profile of each bank reveals these common and divergent features and how they have shaped the banks' international strategies.

Banco Santander, then the largest bank in Spain (see Table 2), was founded in 1857 as a commercial bank. It was also a bank of issue until 1878 when note issuance became a monopoly of the Banco de España. Although Santander initially specialized in the Spanish-American trade flowing through the northern port city of Santander, it did not venture abroad until the 1950s when it opened representative offices in Mexico City and London. In the 1970s and 1980s it expanded its network of offices in Latin America and elsewhere and made a few small acquisitions such as its 1982 acquisition of insolvent Banco Español Chile which it later renamed Banco Santander.

At home, Santander grew via acquisition but remained a mid-sized institution until the late 1980s. Between 1989 and 1992, Santander seized the moment to revolutionize Spain's retail banking by introducing mutual funds, high-yield checking and savings accounts, and low-interest mortgages. The market quickly became too competitive for any major bank to gain significant market share absent mergers so in 1994 Santander bought Banco Español de Crédito (Banesto). This catapulted Santander into first place among Spanish banks. Santander's chairman is Emilio Botín (b. 1934), whose family has controlled the bank since the 1950s.

Santander started its current expansion abroad in the late 1980s with several small acquisitions, including that of Portugal's Banco de Comércio e Indústria in 1990.

Santander's only foray into the U.S. commercial banking market took place in 1991 when it acquired 13.3% of First Fidelity Bancorporation for $650 million. First Fidelity merged with First Union in 1995, and Santander sold its stake in 1997 for $2.2 billion, using the proceeds to amortize the goodwill of its Latin American acquisitions. Santander built its current assault on Latin America around Santander Investment, its investment-banking arm, and many of its acquisitions are banks with a strong local investment banking franchise. The head of Santander Investment was Ana Patricia Botín, the chairman's daughter and his then heir-apparent (she left the bank after the merger with BCH). Santander has generally bought majority stakes in its acquisitions and has put its brand name on them (Interviews #3 and 21). Its Latin American operations accounted for almost 50% of foreign assets and for 48% of net attributable profits in 1997.

Banco Bilbao Vizcaya (BBV), the second largest bank in Spain, is the result of a merger in 1988 between Banco de Bilbao and Banco de Vizcaya. Merchants and industrialists started Banco de Bilbao in 1856 to serve their needs and as a bank of issue. In the following decades it became a key financier for the development of steel making in the Basque region. Banco de Bilbao opened its first foreign office in 1902, in Paris, but remained focused on the domestic market. Banco de Vizcaya started in 1901, also in Bilbao. Both banks grew via acquisition but Vizcaya always had a stronger foreign orientation. In the late 1920s it founded the Banque Français et Espagnol in Paris. From the early 1970s it opened branches in New York, and later Amsterdam, London, Paris and San Francisco and representative offices in Mexico, Frankfurt, Tokyo and Rio de Janeiro.

In the 1990s, BBV followed Santander into Latin America, where BBV originally tended to buy minority stakes, providing the project was large enough and BBV had

management control. Over time the bank gained confidence and knowledge, and when the price was acceptable, it has increased its stake to a majority position. Recently, BBV has appointed a manager in Madrid to be responsible for BBV América (Interview #16), which includes all its Latin American operations. These accounted for 23% of consolidated assets and 17% of net attributable profits in 1997. BBV operates something of a matrix system in which the country manager dominates. Functional managers in each country coordinate with their counterparts in Madrid but do not report to them.

Banco Central Hispano (BCH), the third largest bank in Spain, is the result of a difficult 1991 merger between Banco Central and financially troubled Banco Hispano-Americano. Its founders started Hispano-Americano at the turn of the century with capital repatriated to Spain from its last colonies but the bank became primarily a domestic institution. BCH inherited a number of investments that Central and Hispano-Americano had made in the 1960s, but disposed of or reorganized most of these. BCH was therefore a latecomer in the recent Spanish drive into Latin America. It was also the only bank that accomplished its entry through joint venture arrangements with local partners.

In 1999 Santander and BCH announced their merger. Banco Santander Central Hispano is now the largest commercial bank on the Iberian peninsula. The Co-Chairmen of the merged bank are the previous Chairmen of the merged banks, while Ángel Corcóstegui, the CEO of BCH, is now the CEO of BSCH. The merger is resulting in some consolidation of the banks' investments, and a partial divestiture in Chile mandated by the government on the grounds of maintaining competition.

Other Spanish banks have played a role in Latin America, but generally a small one. The most notable is Argentaria, currently undergoing privatization, which is a

government-owned amalgam of several banks. It has reorganized the investments in Chile, Argentina and Uruguay that it inherited from its subsidiary, Banco Exterior, once Spain's official export credit bank. It has kept retail operations in Panama and Paraguay, but is concentrating on corporate banking and foreign trade. Argentaria is also actively pursuing opportunities in pension management, sometimes in partnership with Citibank. Its chairman, Mr. Fransisco González, has argued that "Latin America is not a priority. The payoff for doing things right here [in Spain] is a lot more profitable than buying something in Latin America" (Financial Times, May 14, 1997).

Where: Latin America

Given that the Spanish banks wished to expand internationally in order to overcome competitive saturation in the home market, the issue of where to go was relatively straightforward. Western Europe was already well-served by domestic institutions and the Spanish banks had already established themselves in their nearest neighbor, Portugal. BBV and Santander had acquired local banks and BCH had taken a minority position in BCP-BPA, the largest Portuguese bank. Elsewhere, the markets were already mature and offered no particular foothold. As the Deputy Chairman of BBV once pointed out, the US$3 billion that BBV had invested in all of Latin America to that time would not have bought them one percent of the market in a major European country such as Italy.

Still, the Spanish banks have acquired some small banks, taken small (generally less than 10%) stakes in larger banks, and also established strategic alliances in Europe. BBV is a member of the Trans-European Banking Services Group (est. 1997), which brings together eleven European banks, and Inter-Alpha (est. 1972), which brings together

thirteen banks. These alliances represent agreements between the banks to share information and generally not to compete with each other (Marois & Abdessemed 1996). Santander has an alliance with Royal Bank of Scotland (RBS). They also jointly control RBS Gibraltar where Santander owns 49.9% of the equity and RBS the rest.

With Europe being of only limited interest, that left the emerging markets of Asia, Eastern Europe and Latin America. Before the recent crisis, most Asian countries did not permit foreigners to acquire local commercial banks. Also, the Spanish banks clearly had no particular advantage vis-à-vis other foreign banks in either Eastern Europe or Asia, except in the Philippines where Santander did establish a subsidiary. Lastly, other European banks, many with historical ties to the region such as the Germans and Austrians, had already established themselves in the countries of Eastern Europe.

Conversely, the commonality of language has made Latin America comfortable for the Spanish and permits easy communication (there is no need to translate memos or manuals) and transfer of managers (Interviews #12 and 19; Caves 1996; Johanson and Vahlne 1977). Lastly, the Spanish banks already had some familiarity with the region. All had had some offices, branches or small subsidiaries there since the 1970s and early 1980s. In the late 1980s, Santander Investments re-entered several Latin American countries from which Santander had withdrawn at the start of the debt crisis. This is consistent with Johanson and Vahlne's (1977) model of internationalization as increasing commitment accompanying increasing knowledge.

We can observe the same dynamic among the Portuguese banks (Appendix B). In addition to their investments in Brazil that parallel the Spanish in the rest of Latin America, the Portuguese are also returning to their former colonies, especially in Africa.

What: Retail Banking to the Mass Market

The Spanish banks have bought large stakes in large banks. Automatically, they have chosen to compete in the mass market, rather than in a niche (Interviews #7, 9, 14, 16, 17). The Spaniards are competing in the lower and middle-income (LMI) markets where they come into competition with the largest domestic banks. The only foreign bank that had previously made foray into Latin America comparable in its geographic scope was Citibank. By contrast to the Spanish banks, Citibank traditionally focused on the upper-income market, frequently referred to as the A, B, and C1 segments (Interviews #4 and 12). BankBoston too has focused on the upper-income market, but has such operations only in Argentina and Brazil. Citibank and BankBoston are well-established operations as their presence in many Latin American countries often dates back to the early 1900s. Deutsche Bank and some other Europeans have owned isolated retail operations in Argentina and elsewhere that are indistinguishable in their operations from domestically-owned banks.

The Spanish banks have transferred banking skills that are primarily useful in the mass retail market. Interviews revealed that, after making an acquisition and gaining managerial control, the bank would bring in expertise from the home operation for both the asset and the liability side. Information systems and risk assessment were among the first areas subject to overhaul (Interviews #3, 4, 6, 8, 9, 16-18, 21). The introduction of new products to expand the deposit base would then follow. Innovations that the Spaniards brought in from the home country included banking products with differentiated features such as lottery-linked accounts (Interviews #3, 7, 9, 12, 13, 16, 19; Guillén & Tschoegl

1998) or fast-approval mortgages.

When: Since 1995

The issue of timing emerged from our field research as a key variable in the FDI that we observed. The scissors had two blades: Latin America opened its doors to foreign investment—also in Mexico and elsewhere, governments put banks that they owned on the auction block—at the precise time that the Spanish banks were looking for possible foreign acquisitions (Mas 1995; Molano 1997; Interview #12).

Although the timing and sequence of economic and political opening differ by country, the logical historical reference point is the Latin American debt and banking crises of 1982. Since then, and as Latin America's "lost decade" lingered on, democratically elected presidents came to power across the region. These governments—with the support of broad coalitions of the middle class and business interests—managed to introduce market-oriented reforms of the financial system including liberalization of foreign entry. As Grosse (1997) points out, from 1971 to 1987 the Andean pact countries barred foreign banks from owning more than 20% of local banks. Thus only recently have these countries' banking sectors become ripe for foreign investment.

The Spanish banks were not the only ones to respond to the developing opportunity. As Tables 1 and 3 show, following the start of the Spanish push in 1995, a number of foreign banks also started to buy banks in Latin America. The two with the widest geographic scope were Bank of Nova Scotia (BNS) and Hongkong and Shanghai Banking Corporation (HSBC). More recently ABN-AMRO has joined in. Still, as one can see by comparing the two tables, the Spaniards seem to have a regional strategy aimed at

dominating as many national markets as possible.

At the same time, a normal ebb and flow was also occurring. Thus Deutsche Bank withdrew from its long-time retail presence in Argentina to concentrate on Europe and sold all but one of its branches to Bank Boston. Losses from over-ambitious expansion elsewhere forced Crédit Lyonnais to sell its earlier acquisitions, including one subsidiary to long-established Deutsche Sudamerikanische Bank. Similarly, Banque Sudameris, which has been in Latin America since its foundation as a Franco-Italian overseas bank in 1910, made an acquisition.

However, in general there were few other well-capitalized banks in a position to make acquisitions in the region (Interview #21). Since the early 1990s the Japanese banks have been under tremendous strain domestically and have been withdrawing from investments around the world. Many European banks, including the Dutch and the Germans were busy expanding to Eastern Europe. During the early 1990s American banks were busy with mergers and acquisitions in their home market, though perhaps spurred by the Spanish banks, Citibank, BankBoston and Chase Manhattan have started to make selective acquisitions.

How: Acquisition of Major Domestic Banks

Entry via acquisition rather than via a greenfield operation follows equally from a decision to make a financial investment or from a decision to enter the mass retail market. Obviously, if one's intent is a financial investment then acquiring a suitably sized operation or taking a small portion of a large operation makes more sense than establishing a *de novo* operation that will of necessity be small.

If the entrant wishes to compete in retail banking by introducing new products it is very important to gain market share in significant chunks as opposed to growing organically from scratch. The inability to patent innovations means that having an extensive branch network over which to deliver the product matters. Thus, the entry strategy of the Spanish banks is in sharp contrast to the strategies of Bank of Boston and Citibank, which traditionally have focused on a smaller clientele and hence have been content to grow more organically.

The Spanish banks have kept even their wholly-owned acquisitions as local subsidiaries rather than as branches of the parent.[1] Banks generally use foreign branches for wholesale and corporate banking activities in host countries (Heinkel and Levi 1992), including Treasury (foreign exchange and money market trading). As Sabi (1988) has pointed out, the reasons banks most frequently cite for their presence in LDCs is financing international trade and servicing their home country (corporate) customers, both of which the bank can do more easily via a single branch in a country's financial center. Heinkel and Levi (1992) show that foreign banks respond to different factors when creating subsidiaries then when creating representative offices, agencies or branches. Unless forced to by local regulation, banks do not use subsidiaries as a substitute for other organizational forms. Subsidiaries appear frequently simply to represent financial investments, vehicles

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[1] Branches are an integral part of the parent; a branch cannot fail unless the parent fails. Subsidiaries and affiliates are separate legal entities, and typically, incorporated in the host country. Because it is a separate entity, a subsidiary may fail even though the parent is solvent. Conversely, a subsidiary may be solvent even though the parent has failed. Under the Basle agreements, host country supervisory authorities are responsible for prudential supervision of subsidiaries and home country authorities for branches of the parent.

for specialized activities such as leasing or commercial credit, or the vehicle for retail banking.

The Spanish banks (including Argentaria) had had some existing operations in Latin America since at least the 1970s. These were generally branches and representative offices in the various national financial centers, though there were a few small retail subsidiaries as well. Had the banks simply wished to continue to serve their existing Spanish corporate customers, this network of branches, perhaps augmented slightly, would have sufficed. Again, this is the strategy that Argentaria is following and the push into mass-market retail banking does not mean that BSCH or BBV have abandoned their traditional corporate business. As far as retail banking is concerned, Santander at least could have built such an operation on the basis of organic growth. However, it was Santander that set off the rush by buying large, existing local banks, even in places such as Chile where it had a small subsidiary.

Beyond the issue of greenfield vs. acquisition, it is important to explain why the three Spanish banks followed different entry strategies regarding majority vs. minority stakes, joint venture partners, and the degree to which head-office involves itself in the management of the acquired banks. Santander has been most aggressive in seeking majority stakes with full managerial control and brand-image coordination, whereas BBV initially preferred minority stakes, gradually increasing them over time (Interviews #3, 21 and 16). In sharp contrast to either of these two strategies, BCH has opted for joint ventures with local partners without promoting its own brand (Interviews #19 and 21).

Santander was the most assertive in its Latin American expansion primarily because of its strong capital base, prior investment banking experience in the region, and the strong

personality and leadership of its chairman—who likes to make expeditious and far-reaching decisions. Numerous press reports contrast Santander's "presidencialista" style with BBV's "team style" of management. Our interviewees singled this out as a key difference between the two banks (Interviews #3, 6, 8, 9, 16-18 and 21; Euromoney Sep 1997: 209-216; AméricaEconomía Dec 1997: 58-66 and Jun 4, 1998: 44-47).

Initially BBV was more cautious than Santander because BBV lacked the exposure to the region that Santander Investment had given Santander. BBV has now inaugurated the "1000 Days Plan." This is its new international strategy and one which explicitly aims at creating shareholder value. The first phase included the acquisition of leading local banks in Latin America. Over the last three or four years, BBV has leveraged its strong capital base and managerial resources to take full control and coordinate its strategy across borders. Currently the bank is in the second phase of the plan: consolidation to cut costs and increase efficiency throughout the BBV system, including Latin America. As a bank run by managers rather than a dominant owner, BBV may also have been more tolerant of partners (Interviews #16 and 18).

Lastly, BCH has been the weakest in terms of having the resources on which to build its international expansion. Of the three, it is the least profitable and has the least managerial depth (Interview #21). The difference in behavior between Santander and BBV on the one hand and BCH on the other is consistent with Kindleberger's (1969) argument for FDI as stemming from "surplus managerial resources." This, in turn, is consistent with resource-based views of the firm.

BCH's decision to enter into joint ventures with local partners also reflected its perception that the risks of entering emerging markets were high. BCH allied itself with

the Luksic group, one of the largest family-controlled industrial and service conglomerates in Chile. The investment vehicle was O'Higgins Central Hispano (OHCH), an almost 50-50 joint venture (BCH held a few more shares than did the Luksic group). BCH had acquired banks in the Southern Cone through OHCH rather than directly, and was looking for a partner for northern South America. In Mexico and elsewhere BCH had taken minority stakes and in Puerto Rico it sold its subsidiary to Santander. In the opinion of Ángel Corcóstegui, its CEO, the joint venture arrangement allowed BCH to test the waters, learn, and then consider whether to escalate its commitment or not. Also, this strategy hedged against the possible emergence of xenophobia in the host countries. The enthusiasm for foreign owners as rescuers of the banking system may fade over time, only to be replaced by concern over foreign domination (Interviews #14 and 19). Since the merger with Santander, BSCH has bought-out the Luksic group's share in OHCH for a reported US$4-600mn.

Why: Asset Seeking and Exploiting, and Oligopolistic Reaction

Williams (1997) provides a recent and comprehensive review of the literature on FDI in banking. His assessment is that the internalization approach, which traces back to Hymer (1976) and Kindleberger (1969) provides an adequate general explanation. That said, most of the extant empirical literature uses aggregate and macroeconomic data to examine what in fact is a microeconomic phenomenon. It also tends to focus on FDI in corporate and wholesale banking (Grubel 1977), precisely because of the relative rarity of FDI in retail banking.

Three sets of explanations for the Spanish banks' sudden rise to international

prominence emerge from our analysis of the evidence. The first two explanations fall under Caves' (1996, 1998) rubrics of asset-seeking and asset-exploiting behavior. The third is oligopolistic reaction (Hymer 1976; Knickerbocker 1973).

Asset-Seeking

The Spanish banks have been seeking to enter markets that permit them faster growth and higher margins than they are able to achieve at home, as virtually each of our interviewees explained. As Table 4 shows, Latin America differs both from the Asian emerging markets and the advanced markets in terms of the development of the banking sector. The ratio of money supply to GDP (a rough guide to the size of the banking sector relative to that of the economy) is lower than elsewhere. Also, expenses in Latin America, and interest margins, even net of expenses, are higher than elsewhere. As we will discuss below, the Spanish banks believe that they can introduce efficiencies. Even without this, the Spanish saw markets that provided the possibility of growth with the development of the banking sector and high margins.

As Ragazzi (1973) has pointed out, barriers to the flow of portfolio capital alone may motivate FDI. There is no penalty to acquiring assets when barriers segment capital markets. If it is cheaper for Santander to assemble a portfolio of Latin American banks than for its shareholders to do it by themselves, FDI itself adds value even if the investor does not change cash flows in the acquisitions (Errunza and Senbet 1981).

One should also note that the investments in Latin America are both a poison pill to some acquirers and a distinct bargaining chip vis-à-vis others. Spain has formed part of the European Union since 1986 and is one of the initial entrants into the Euro. A single

financial market and currency in Europe may encourage other European banks to examine the Spanish banks as possible acquisition targets. As Emilio Ybarra, Chairman of BBV, has pointed out, "BBV's global franchise in Latin America represents a substantial interchange value for any future agreement with European banks." The Madrid daily, El País (July 9, 1998, p. 51) has reported Rolf E. Breuer, President of Deutsche Bank, as saying that Spanish banks "are not big enough" to compete in the new European market. He added that their "aggressive though successful" position in Latin America has turned them into "attractive partners" for future mergers or alliances.

Asset-Exploiting

The Spanish banks are not just passive acquirers of assets. If they were, there would be no need to insist on management control. Their public statements and our interviews (Interviews #3, 4, 6, 8, 9, 14, 16-18 and 21), clearly signal that the Spanish banks believe that they have something to offer. That is, they believe that they can improve cash flows in their acquisitions. Having just gone through a transition at home from non-competitive to extremely competitive markets (Peréz 1997), they believe that they have relevant skills and experience to bring to the table. The evidence is mixed, but suggests that after some turbulence around deregulation, the Spanish banks overcame their earlier limitations and became efficient (Rodríguez 1989; Grifell-Tatjé & Lovell 1996; Maudos, Pastor & Quesada 1997).

The starting point for what Caves (1998) has called asset-exploiting explanations for FDI is Hymer's (1976) classic proposition: "Given the costs of operating at a distance and in an unfamiliar environment, the foreign firm must have some off-setting advantage if it is

to compete against local firms." Retail banking is a mature industry in which one cannot patent one's innovations. Hence foreign banks generally have no advantage vis-à-vis the local banks. One common exception is ethnic banking—providing banking services to home-country emigrants resident in the host country. Ethnic banking is not what the Spaniards are doing in Latin America, and opportunities for ethnic banking are limited, especially when the host country and the immigrants share a language. Thus, Tschoegl (1987) has argued that one should generally not expect to see foreign banks entering retail markets. Dufey and Yeung (1993) make the same point for the prognosis for evolution of banking in the European Union. Ethnic banking aside, Tschoegl (1987) did suggest two situations where FDI in retail banking might be possible for a time. The first case is in markets where the incumbent banks are not very competitive, perhaps because of a dominant oligopoly. The second case is in fast growing markets.

Relative to domestic banks in Latin America, the Spanish banks are better managed and have more experience with a competitive market. Some of the local banks, frequently the largest, are government-owned. As Marichal (1997) points out, dominance of banking by government-owned banks, especially in Argentina, Brazil, Chile and Mexico, dates from the 19th century. For the six Latin American countries in Table 4, the share of banking system assets in government banks averages 30%. Typically, government-owned banks have created price and service standards that have taken little effort to match. Often this has been an unintended consequence of implicit taxes in the form of policy mandates to maintain employment, uneconomic branches in rural areas and preferential services for designated recipients (Grosse 1997). Generally, the lack of a rivalrous domestic market has left the locally-owned but non-government banks backward. The Spanish banks in

Latin America then provide an interesting example of a situation where the foreign direct investors have no advantage vis-à-vis each other, but do vis-à-vis their host-country competitors. This is in line with Hu's (1995) warning against blindly inferring an entrant's advantage abroad from their advantage at home.

The Spanish banks have transferred knowledge from Spain to Latin America. One obvious parent contribution has been the introduction of an aggressive posture built on the introduction of new products. Generally, wherever local regulations have permitted it, the Spanish banks have introduced the lottery-linked deposit accounts they offer in Spain (Guillén & Tschoegl 1998); these have been an innovation everywhere the Spanish banks have introduced them. The banks have also improved the issuing, pricing and term of mortgages relative to all the banks targeting the mass market, introduced mini-branches in supermarkets, gas stations and other non-traditional venues, and generally improved the assessment of credit risk and other banking processes in the banks they have acquired.

Both Santander and BBV make use of expertise within their subsidiaries. Both send individual executives and teams on short-term assignments to other subsidiaries to help with specific projects such as the introduction of new systems or products. BBV also has a program under which 50 lower and middle managers from Latin America will work in BBV Spain for two years in regular jobs (not internships), before returning to their home banks. In some cases the parents have brought in senior managers from Spain.

One could argue that relative to most other foreign banks the Spaniards have a linguistic and cultural advantage though this is not as true in the case of the long-established foreign banks such as Citibank and BankBoston. Citibank and BankBoston have tried to be "embedded"—Citibank's term—in each host country. This has led to a

cream-skimming strategy of corporate banking and banking to urban professionals while not pushing the limits in terms of aggressiveness. Neither Citibank nor BankBoston targeted the mass market that the Spanish banks targeted through their acquisitions. In his survey of 16 US, Canadian and Netherlands banks in Latin America, Grosse (1997) found that these banks had a strong orientation towards wholesale commercial banking, and little interest in retail banking. Lastly, the very few other foreign-owned retail banks in Latin America prior to the acquisition wave that followed the Spanish banks (again, Table 3) were indistinguishable in their behavior from the domestic banks. Thus to a great degree the Spanish banks' chief competitors have been each other. Citibank and BankBoston's recent acquisitions of local banks or branches suggest that the banks' strategies may be changing.

Second, rapidly growing markets tend to be forgiving ones. If most of the participants are fully occupied with simply managing the problems of average growth, they will have neither the time nor the resources to devote to taking market share away from each other. The countries in Latin America are underbanked with a low density of bank branches. Now that these countries are recovering from the "lost decade," the situation is one in which the opportunities for growth may not depend solely on taking market share away from others.

Oligopolistic Reaction

In addition to asset seeking and exploiting, the whole expansion of the Spanish banks represents a case of oligopolistic reaction. In the "oligopolistic reaction" pattern that Knickerbocker (1973) and Flowers (1976) first identified, a firm matches the location

choices of a rival in a pattern of move-countermove or action-reaction. The pattern may begin with one firm (e.g., Santander) making the first move and others (e.g., BBV and BCH) following the leader, but as in the case of the Spanish banks, a leapfrogging of leadership occurs so that at some point one can no longer unambiguously describe one firm or the other as the overall leader.

Oligopolistic reaction is a form of rivalrous behavior that stands in contrast to the "mutual forbearance" pattern in which a firm avoids markets in which a rival has already established itself and the rival reciprocates. Yu and Ito (1988) and Ito and Rose (1994) found evidence of oligopolistic reaction among manufacturing firms. Empirical studies of banks offer mixed results. While Choi et al., (1986, 1996) found support for forbearance among large, international banks, Ball and Tschoegl (1982) found evidence consistent with oligopolistic reaction for foreign banks establishing themselves in Tokyo and California. Engwall and Wallenstäl (1988) argued that Swedish banks in their internationalization copied each other. Jacobsen and Tschoegl (1998) argued that the Nordic consortium banks may have exhibited both oligopolistic reaction and some mutual avoidance depending on the characteristics of the places involved. That is, they clustered in major international financial centers such as London and New York, and avoided each other elsewhere. By contrast, the Spanish banks were engaging in oligopolistic matching in Latin America, not mutual forbearance, something that the bankers that we interviewed fully acknowledged (Interviews #4, 5, 10 and 21).

In oligopolistic reaction the reference set starts parochial and in time may become, in Perlmutter's (1969) terms, geocentric. The Spanish banks started by reacting primarily to each other's moves but now have by-and-large established their Latin American networks.

This has brought them into contact with competitors such as Citibank and HSBC, both of which have built worldwide networks that include Latin America. They are also now in contact with Bank of Nova Scotia and other Canadian banks that have started to expand beyond the Caribbean (Baum 1974) into Latin America. Before, the Spanish banks met Citicorp only in a few financial centers around the world, and HSBC and Bank of Nova Scotia in even fewer, and probably competed little if at all with them. Now they are all competing intensively with each other throughout Latin America.

Conclusion

The three strategic behaviors we have observed—asset seeking, asset exploiting and oligopolistic reaction—provide the basis for formulating the following explanation for the massive presence of Spanish banks across retail banking markets throughout Latin America. By the late 1980s the Spanish banking market was becoming saturated and rivalrous. Consequently, the Spanish banks sought other growth opportunities. For a variety of reasons Europe, Eastern Europe and Asia held limited attraction. However, banking markets in Latin America were facing in the early 1990s the kind of deregulation and liberalization that the Spaniards had experienced in their home market a few years back. Once one bank, Santander, started to invest in Latin America, oligopolistic reaction set in. The other two leading Spanish banks quickly matched Santander as all three raced to acquire banks across the region. Here, in environments that were linguistically and culturally comfortable, the Spanish banks started to transfer their technology and knowledge about product differentiation to their acquisitions and hence host countries.

Spanish banking FDI in Latin America requires understanding the shifting competitive

environment of banking over the last decade. Financial deregulation and privatization in Europe and Latin America have opened up new horizons, and have enhanced competition via product differentiation and effective leverage of new information and telecommunications technologies. The Spanish banks have been uniquely exposed to these winds of change because of their sudden exposure to European financial liberalization and Latin American opportunities for growth.

Although the Spanish banks' expansion is a breakthrough in retail banking, it does not pose a serious problem to existing theories of FDI. Asset-seeking, asset-exploiting and oligopolistic behaviors account for the Spanish banks' Latin American expansion. Scholars initially formulated the bulk of FDI theory with manufacturing activities in mind; still extensions to service industries such as banking are indeed appropriate and useful. However, more research is needed better to understand and measure the intangible assets that multinational banks bring to bear and better to grasp what leads banks to use different entry strategies.

Appendix A: Interviews

In our interviews we promised confidentiality to our respondents. Therefore, we note below the institutional affiliation of our interviewees as well as the place and date of interview but do not reveal names or titles. We have listed the interviews chronologically. Interviews lasted between 30 and 90 minutes, with an average of about 45 minutes. The 33 interviewees included presidents, CEOs, vice-presidents or director-generals of 21 different banks, bankers' associations and regulatory agencies in Argentina, Chile, México and Spain. Therefore, in some cases more than one interviewee was present at the interview.

List of Interviews

No.	Venue	Date	Institution
1.	Santiago	May 4, 1998	Superintendency for Banking and Financial Institutions
2.			Banco Central de Chile
3.		May 5, 1998	Banco Santander Chile
4.			Citibank, Chile
5.		May 6, 1998	Research Department, Superintendency for Banking and Financial Institutions
6.			Banco de Chile
7.			Santander Investment
8.	Buenos Aires	May 7, 1998	Santander Investment
9.			Banco Río de la Plata
10.			BBV Banco Francés
11.			Superintendency of Financial Institutions, Banco Central de la República Argentina
12.		May 8, 1998	Financial Institutions Clearing House, Banco Central de la República Argentina
13.			Citibank Argentina
14.			Asociación de Bancos de la República Argentina
15.	Mexico City	May 13, 1998	Financial Sector Bureau
16.			National Banking and Securities Commission
17.		May 14, 1998	Banco Bilbao Vizcaya
18.			Grupo Santander Mexicano
19.	Madrid	June 17, 1998	Banco Central Hispano
20.			Inspection Bureau for Credit and Savings Institutions, Banco de España
21.		June 22, 1998	Banco Bilbao Vizcaya
22.		June 25, 1998	Banco Santander

Appendix B: The Portuguese Banks in Brazil and Latin America

Portuguese banks too have recently started to acquire retail-oriented commercial banks in Brazil, but little elsewhere in Latin America. While significant, the Latin American operations of Portuguese banks, however, do not nearly compare to those of the Spaniards, especially with respect to geographic scope.

Like Spain, Portugal has undergone substantial deregulation. The nationalizations of 1975, led to a banking system that was 95% government-owned, though the three foreign-owned banks (including Banco do Brasil which had entered in 1975) were unaffected. A gradual process of deregulation began in 1984 with reprivatization starting in 1989 (Barros 1995). In 1991 the Espirito Santo family reclaimed Banco Espirito Santo e Commercial. Since 1994, a wave of mergers has swept Portugal and the banking market is now one of the freest in Europe.

Banco Financial Portugues (BFP) has been in Brazil since 1887, however in a very limited capacity. For much of its history it apparently existed to support the financial affairs of the Portuguese consulates there. Other Portuguese banks that entered between 1900 and World War I included Banco Alliança (1906; head office Opporto), and Banco Nacional Ultramarino (1912; head office Lisbon). Levy (1991) points out that the foreign banks in Brazil were, “above all, tuned to international trade.”

Caixa Geral de Depositos (CGD), the largest bank in Portugal and still government-owned, has been in Brazil since 1924. In 1972 it bought BFP. It also bought 8% of Banco Itau, Brazil’s second largest private bank. In 1997, CGD bought 79% of Banco Bandeirantes; the acquisition will add 575 branches to the 3 that it owns through BFP. CGD also has a representative office in Mexico and another in Venezuela.

Banco Espirito Santo (BES) entered Brazil in 1975, just before the bank's nationalization. In 1976 it established Banco InterAltantico, a merchant bank consortium that it co-owned with Credit Agricole of France, and the Brazilian industrial group, Monteiro Aranha. In 1998, InterAtlantico acquired Banco Boavista, the 14th largest Brazilian bank, from the Paula Machado family; the owners have merged the two banks into Banco Boavista InterAtlantico which is now the 9th largest bank. BES also has a representative office in Venezuela. BES is a member of the Inter-Alpha banking club, as is Banco Bilbao-Vizcaya from whom it bought 17 branches in Spain.

In 1991, Banco Comercial Portugues established a cross-shareholding agreement with Banco Central Hispano of Spain. BCP now owns 6% of BCH and BCH owns 14% of BCP. In 1992, the two each took 8% of Banco Bital in Mexico. Reportedly, BCP wishes to withdraw from Bital. Doing so would leave BCP with no operations in Latin America.

In 1993, Banco Portugues do Atlantico (BPA) established a subsidiary in Brazil. Banco Commercial Portugues (BCP) took control of BPA in 1995 and in 1998 sold the Brazilian operation to Wachovia Bank of the US, which changed the name to Banco Wachovia. In 1998 Banco Portugues de Investimento (BPI) announced that it would open a representative office in Brazil and expand into securities. Banco Itau owns 10% of BPI, which has said that it does not intend to enter retail activities.

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Table 1: Acquisitions of Banks[1] in Latin America since 1990 by Spanish Banks

Acquisition Year[2]	Acquirer	Bank Acquired	Country	% Stake[3]	Purchase Price US$mn[3]
1990	Santander	Caguas Central Federal Savings Bank	Puerto Rico	100	51
1991	BBV	Probursa	Mexico	70	480
1992	BCH	GFBital	Mexico	8	105
1995	OHCH[4]	Banco Santiago	Chile	79[6]	1050[6]
	OHCH	Banco del Sur	Peru	49	108
	Santander	Banco Interandino & Intervalores	Peru	100	45
	Santander	Banco Mercantil	Peru	100	44
1996	BBV	Banco Francés del Río de la Plata	Argentina	52	300
	BBV	Banco Ganadero	Colombia	59	328
	BBV	Banco Oriente & Banco Cremi	Mexico	100	21
	BBV	Banco Continental	Peru	60	256
	BBV	Banco Provincial	Venezuela	40	300
	OHCH	Banco Tornquist	Argentina	100	75
	Santander	Banco Osorno y La Unión	Chile	51	496
	Santander	Banco Central Hispano Puerto Rico	Puerto Rico	99	289
	Santander	Banco de Venezuela	Venezuela	93	351
1997	BBV	Banco de Crédito Argentino	Argentina	100	466
	Santander	Banco Río de la Plata	Argentina	64	1068
	Santander	Banco Noroeste	Brazil	80	500
	Santander	Banco Geral do Comercio	Brazil	50	202
	Santander	Banco Comercial Antioqueño	Colombia	55	146
	Santander	Grupo Financiero InverMéxico	Mexico	61	502
1998	BBV	Banco Industrial	Bolivia	[5]	
	BBV	Banco Excel Economico	Brazil	55	450
	BBV	Banco Hipotecario de Fomento	Chile	55	352
	BBV	Banco Ponce	Puerto Rico	100	166
	BBV	Opns. of Chase Manhattan	Puerto Rico		50-60
	BBV	Banco Pan de Azúcar	Uruguay	[5]	
	BCH	Banco de Galicia y Buenos Aires	Argentina	10	c.200
	OHCH	Banco Santa Cruz	Bolivia	100	160
	OHCH	Banco Asunción	Paraguay	[5]	
1999	Santander	Banco de Río Tercero	Argentina		6
	BBV	CorpBanca	Argentina	100	84

Sources: Annual reports and news reports.
Notes: 1) We have not listed the numerous acquisitions of credit card, consumer and commercial loan, insurance, stock brokerage and pension fund management companies. 2) Year of initial purchase even if subsequent purchases followed. 3) Cumulative to present. 4) OHCH was a holding company jointly owned by Banco Central Hispano (BCH) and the Luksic family through its holding in Banco O'Higgins. 5) Announced but not yet completed. 6) In 1999, BSCH paid US$800mn for the 35% of the bank owned by the government.

Table 2: Characteristics of the Leading Spanish Financial Institutions, 1997

	Santander[a]	BBV	BCH
Assets (bn$)	171	139	77
Net loans (bn$)	72	57	39
Net interest income/ATA	2.3	3.0	2.7
Operating expenses/ATA	2.6	2.8	2.5
ROA (%)	0.7	1.0	0.6
ROE (%)	19	18	11
Branches (Spain)	3,842	2,829	2,659
Branches (Abroad)	1,446	1,520	212
Employees	72,740	60,282	27,930

Note: [a] Includes Banesto.
Source: J.P. Morgan.

Table 3: Acquisitions of Banks in Latin America since 1990 by Foreign (non-Spanish) Banks

Acquisition Year[1]	Acquirer	Bank Acquired	Country	% Stake[2]	Purchase Price US$mn[2]
1992	Bank of Nova Scotia	GFInverlat	Mexico	15	106
1994	Infisa (Chile)	Banco Consolidado (Corpbanca)			
1995	Banco Sudameris (Banca Commerciale	Banco de Lima	Peru	68	n.a.
	Deutsche-Sudamerika-nische Bank	Banco Credit Lyonnais Chile	Chile	88	49
1996	Banco Espirito Santo & Credit Agricole[3]	Banco Boavista	Brazil	c. 4(	120
	Bank of Montréal	GFBancomer	Mexico	16	475
	Bank of Nova Scotia	Banco Quilmes	Argentina	95	245
	Bank of Nova Scotia	Banco Sudamericano	Peru	25	14
	Citibank	Confia	Mexico	100	45
	Credit Agricole	Banco Bisel	Argentina	64-68[4]	131
	HSBC	Banco Roberts	Argentina	70	668
	HSBC	Bamerindus	Brazil	100	940
	HSBC	Banco Santiago	Chile	7	144
	HSBC	Banco Serfin	Mexico	20	300
	HSBC	Banco Sur	Peru	10	16
1997	Chase Manhattan	Banco Consolidado	Venezuela	90	
1998	ABN Amro	Banco Real[6]	Brazil	Maj.	2100
	ABN Amro	Banco do Estado de Pernambuco	Brazil	100	154
	Caixa Geral de	Banco Bandeirantes	Brazil	79	64-300[5]
	Citibank	Banco Mayo Cooperativo	Argentina	100	n.a.
	Wachovia Bank	Banco Portugues do Atlantico-Brasil	Brazil		
	Bank of Nova Scotia	Banco del Caribe	Venezuela	25	88
	Standard Chartered	Extebandes			165

Sources: News reports.
Notes: 1) Year of initial purchase if subsequent purchases followed. 2) Cumulative to present. 3) The two banks jointly own Banco InterAtlantico-see Appendix B-into which they have merged Boavista. The shareholding percentage refers to Banco Espirito Santo, whereas the US$ amount is the total price the banks paid Boavista. 4) Reports differ; also, Credit Agricole owns 20% of Chile's Banco del Desarrollo, which owns 15% of Bisel. 5) Reports differ. 6) The deal includes subs in Argentina, Colombia, Paraguay, and Uruuguay.

Table 4: Comparative banking statistics of selected emerging and developed economies

	M2/GDP[1]	Bank share in financial intermediation[2]	Share of state-owned banks[3]	Share of foreign-owned banks[5]	Non-interest operating costs[6]	Net interest margins[7]	Non-performing loans[8]
Argentina	19	98	36	22	8.5	9.2	11
Brazil	26	97	48	9	6.0	6.8	6
Chile	36	62	14	21	3.0	6.1	1
Colombia	20	86	23	4	7.3	8.3	3
Mexico	25	87	28	1	3.9	5.1	15
Venezuela	17	92	30	1	5.7	8.1	18
India	45	80	87	7	2.6	2.9	20[9]
Hong Kong	166	…	0	78[4]	1.5	2.2	3
Singapore	81	71	0	80	1.4	1.6	…
Indonesia	47	91	48	4	2.4	3.3	11
South Korea	43	38	13	5	1.7	2.1	1
Malaysia	85	64	8	16	1.6	3.0	8
Taiwan	n.a.	80	57	5	1.3	2.0	3
Thailand	75	75	7	7	1.9	3.7	8
Germany	64	77	50[4]	4	1.1	1.4	…
Japan	111	79	0	2	0.8	1.1	3
Spain	78	…	…	2	…	…	4
United States	60	23	0	22	3.7	3.7	2

Notes: 1) Money and quasi money as a percentage of GDP in 1996; Malaysia in 1995. 2) Assets as a percentage of the assets of banks and non-bank financial institutions in 1994. 3) Percentage share of assets in 1994. 4) Not strictly comparable. 5) Percentage share of assets; date not given. 6) As a percent of total assets, averaged over 1990-94. 7) As a percent of total assets, averaged over 1990-94. 8) Average 1994-95; these figures may not be strictly comparable. 9) Relates only to public sector banks.

Source: World Bank, World Development Indicators 1998. Goldstein, M. and P. Turner. 1996. "Banking Crises in Emerging Economies: Origins and Policy Options." BIS Economic Papers No. 46.